

CONCURRENCE IN SENATE AMENDMENTS

AB 37 (Jones-Sawyer)

As Amended August 30, 2019

Majority vote. Tax Levy

SUMMARY:

Specifies, under the Personal Income Tax (PIT) Law, that the federal disallowance of tax expenditures related to the illegal sale of drugs shall not apply to licensees engaged in commercial cannabis activities in California.

The Senate Amendments:

- 1) Provide that this bill's provisions apply to taxable years beginning on or after January 1, 2020, and before January 1, 2025.
- 2) Clarify that this bill's provisions apply to credits as well as deductions.
- 3) Require the Franchise Tax Board (FTB) to provide specified data in a report to the Legislature on or before July 31 of each calendar year in which either the deductions or credits are allowed.
- 4) Specify that this report shall be submitted in compliance with Government Code Section 9795.

COMMENTS:

- 1) *An overview of federal law:* Under Internal Revenue Code (IRC) Section 280(E), no deduction or credit is allowed for any amount paid or incurred during the taxable year in carrying on a trade or business if such trade or business consists of trafficking in controlled substances prohibited by federal or state law. The federal Controlled Substances Act, in turn, lists cannabis as a Schedule I controlled substance. As a result, a business that sells cannabis is barred from deducting what would otherwise be ordinary and necessary business expenses.
- 2) *An overview of state law:* Under state law, the treatment of ordinary and necessary business expenses from commercial cannabis activities differs depending on whether the taxpayer is subject to the PIT Law or the Corporation Tax (CT) Law.
 - a) *CT Law treatment:* For corporations, California has standalone law. As such, the automatic denial of deductions specified by IRC Section 280E does not apply. An entity taxed as a corporation under the CT Law that is involved in commercial cannabis activities is allowed to deduct its ordinary and necessary business expenses, assuming the entity has adequate substantiating records.
 - b) *PIT Law treatment:* The PIT Law, however, conforms to IRC Section 280E. Therefore, California follows the federal treatment of cannabis sales, and disallows a deduction for ordinary and necessary business expenses.
- 3) *This bill:* This bill is designed to equalize the treatment of taxpayers subject to the CT Law and the PIT Law by allowing taxpayers subject to the PIT Law to deduct their ordinary and necessary business expenses related to licensed commercial cannabis activities.

According to the Author:

"The cannabis industry has multiple barriers to entry – limited access to banking, compliance with complex state regulations and a high tax burden. In addition to these challenges, the federal government continues to treat our state's legal industry as a criminal activity. Current state law conforms to federal policies that disallow tax deductions for businesses that "traffic" controlled substances, resulting in higher taxes for legal cannabis businesses. Californians voted overwhelmingly to make cannabis a legal enterprise in our state and to benefit from the tax revenue brought in by this new industry. High taxes imposed on legal cannabis products are putting the legal industry at a disadvantage in competing with the illicit market, which results in less tax revenue for the state. AB 37 will ensure that cannabis businesses are taxed like any other legal industry in our state and will help legal businesses thrive in California."

Arguments in Support:

None submitted for current version of this bill.

Arguments in Opposition:

None submitted for current version of this bill.

FISCAL COMMENTS:

According to the Senate Appropriations Committee, the FTB indicates that the revenue loss resulting from this bill is interminable, because it lacks the historical data required to develop a reliable estimate. However, the annual revenue loss resulting from the bill would likely be in the tens of millions of dollars annually (General Fund). FTB's administration costs would be minor and absorbable.

VOTES:

ASM REVENUE AND TAXATION: 10-1-0

YES: Burke, Brough, Chu, Gray, Mayes, Mullin, Petrie-Norris, Quirk, Luz Rivas, Ting

NO: Melendez

ASM APPROPRIATIONS: 17-1-0

YES: Gonzalez, Bloom, Bonta, Brough, Calderon, Carrillo, Chau, Diep, Eggman, Fong, Gabriel, Eduardo Garcia, Maienschein, Obernolte, Petrie-Norris, Quirk, Robert Rivas

NO: Bigelow

ASSEMBLY FLOOR: 69-1-10

YES: Aguiar-Curry, Arambula, Bauer-Kahan, Berman, Bloom, Bonta, Brough, Burke, Calderon, Carrillo, Cervantes, Chau, Chen, Chiu, Chu, Cooper, Cunningham, Dahle, Daly, Diep, Eggman, Flora, Fong, Frazier, Friedman, Gabriel, Gallagher, Cristina Garcia, Gipson, Gloria, Gonzalez, Gray, Grayson, Holden, Irwin, Jones-Sawyer, Kalra, Kamlager-Dove, Lackey, Levine, Limón, Low, Maienschein, Mayes, McCarty, Medina, Mullin, O'Donnell, Obernolte, Patterson, Petrie-Norris, Quirk, Quirk-Silva, Ramos, Reyes, Luz Rivas, Robert Rivas, Rodriguez, Blanca Rubio, Salas, Santiago, Smith, Mark Stone, Ting, Waldron, Weber, Wicks, Wood, Rendon

NO: Melendez

ABS, ABST OR NV: Bigelow, Boerner Horvath, Choi, Cooley, Eduardo Garcia, Kiley, Mathis, Muratsuchi, Nazarian, Voepel

SENATE FLOOR: 33-5-2

YES: Allen, Archuleta, Atkins, Beall, Bradford, Caballero, Chang, Dahle, Dodd, Durazo, Galgiani, Glazer, Lena Gonzalez, Hertzberg, Hill, Hueso, Jones, Leyva, McGuire, Mitchell, Monning, Moorlach, Pan, Portantino, Roth, Rubio, Skinner, Stern, Stone, Umberg, Wieckowski, Wiener, Wilk

NO: Bates, Borgeas, Grove, Morrell, Nielsen

ABS, ABST OR NV: Hurtado, Jackson

UPDATED:

VERSION: August 30, 2019

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FN: 0001815